

Message Text

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ACTION ARA-10

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FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC PRIORITY 7729

INFO AMEMBASSY MEXICO CITY

AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

LIMITED OFFICIAL USE BRASILIA 7803

PASS TREASURY

E.O. 11652: N/A

TAGS: EFIN, BR

SUBJECT: BRAZILIAN REACTION TO THE FLOATING OF THE MEXICAN PESO

1. BASED ON CONVERSATIONS WITH CENTRAL BANK OFFICIALS DEALING WITH THE EXTERNAL AREA, THE BRAZILIANS APPROVE THE MEXICAN DECISION TO FLOAT (OR DEVALUE) THE PESO AND DO NOT BELIEVE THAT IT IS LIKELY TO HAVE ANY SIGNIFICANT IMPACT ON BRAZIL. THE OFFICIALS WE CONTACTED WERE NOT AT ALL SURPRISED BY THE MOVE, INDICATING THAT THE MEXICAN BALANCE OF PAYMENTS SITUATION HAD REACHED THE POINT WHERE THERE WAS NO ALTERNATIVE TO A DEVALUATION. ALTHOUGH A MORE COMPLETE ANALYSIS IS YET TO BE MADE, THESE OFFICIALS MAINTAINED THAT THE DEVALUATION OF THE MEXICAN PESO IS NOT LIKELY TO HAVE A MAJOR IMPACT ON BRAZIL SINCE (A) MEXICO AND BRAZIL ARE NOT STRONG COMPETITORS AND (B) IT REMAINS

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TO BE SEEN WHETHER MEXICO CAN SIGNIFICANTLY

INCREASE ITS OUPUT TO MEET THE ADDITIONAL DEMAND GENERATED BY THE DEVALUATION. THESE OFFICIALS ALSO BELIEVED THAT, TO THE EXTENT THERE IS AN ADVERSE IMPACT ON BRAZIL, IT WILL PROBABLY BE ON BRAZIL'S SHARE OF THE LAFTA MARKET. THE BRAZILIANS ARE WATCHING DEVELOPMENTS CLOSELY AND A WORKING GROUP HAS BEEN SET UP IN THE CENTRAL BANK TO COME UP WITH A MORE DEFINITIVE EVALUATION. WE WILL KEEP IN TOUCH WITH THE CENTRAL BANK AND REPORT ANY NEW INFORMATION, AS IT BECOMES AVAILABLE.

2. COMMENT: WITH RESPECT TO THEIR OWN EXCHANGE RATE POLICY, GOB OFFICIALS CONTINUE TO MAINTAIN THAT THERE IS NO NEED TO ALTER THEIR SYSTEM OF MINI-DEVALUATIONS. IN FACT, SOME SEE THE MEXICAN DEVALUATION AS A VINDICATION OF THE MINI-DEVALUATION SYSTEM. HOWEVER, THE KEY QUESTION ABOUT THE BRAZILIAN APPROACH IS WHETHER THE MINI-DEVALUATIONS HAVE BEEN SUFFICIENT DURING THE LAST THREE YEARS TO PREVENT AN OVER-VALUATION OF THE CRUZEIRO. GOB FINANCIAL OFFICIALS REPLY THAT THE SYSTEM HAS NOT RESULTED IN OVERVALUATION AND POINT TO THE GROWTH OF EXPORTS IN RECENT YEARS TO PROVE THEIR POINT. EXPORTERS, ON THE OTHER HAND, ARGUE THAT THE CURRENCY IS CLEARLY OVER-VALUED. THE DEBATE CONTINUE, AND ONLY THE TREND OF THE BALANCE OF PAYMENTS IN FUTURE MONTHS WILL DETERMINE WHO IS RIGHT.

CRIMMINS

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